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IN THE SUPREME COURT OF THE UNITED STATES.

October Term, 1954.

No. 274

PHILLIPS PETROLEUM COMPANY, A CORPORATION,
Petitioner,

vs.

CABOT CARBON COMPANY, A CORPORATION,
Respondent.

PETITIONER'S REPLY TO BRIEF OF RESPONDENT.

Under the guise of correcting "erroneous and misleading" statements of Petitioner, Respondent has misstated the facts in several respects. Except for two instances bearing directly upon the validity of Respondent's theory of recovery, we shall not take the time of the Court to point out the details of other misstatements.[1] Rather, it is believed that

1. At page 2 of its brief Respondent states:

"In paragraph 4 of the contract (R. 32) it was agreed that *Phillips would purchaes Cabot's share of the gas*, when produced, at a price of 4c per thousand cubic feet."

That is not true as will be seen from that paragraph as quoted by Respondent on the same page of its brief. It is true (and has been so stated by Petitioner (Pet., p. 7), and not "consistently erroneously alluded to indirectly" as asserted by Respondent) that the contract provided that Cabot should reserve an undivided interest in the natural gas underlying said lands or in any natural gas which may be produced therefrom, but it also provided that Phillips should "become the owner of the gas when produced" and should account to Cabot at a value of 4c per MCF for 1/4 of 7/8 of the gas produced. But the contract does *not* say, as Respondent says it does, that "Phillips would *purchase* Cabot's share of the gas, when produced, at a price of 4c per thousand cubic feet."

Respondent would have been more frank with the Court if it had said that *it construes the contract to mean* that Phillips would purchase

the Court will be best aided by our pointing up some of the basic issues which call for review by this Court of the decision below.

One of the fundamental questions presented is whether the Federal Courts are to be allowed to take over and administer the state conservation laws or whether that function is to remain with state administrative bodies. That question is squarely presented by the decision below holding that the Corporation Commission's minimum price orders mean one thing and the Corporation Commission's holding (Order No. 28884, dated July 16, 1954) that it intended no such thing and that as construed by the court below the minimum price orders would not serve either of their intended purposes—the prevention of waste and the

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FOOTNOTE 1—*Continued*:

Cabot's share of the gas. But such construction would be in the teeth of the Oklahoma law that oil and gas are not susceptible to ownership prior to production and that the payment of overriding royalties by the oil and gas lessee is not payment for the gas but is payment of the consideration for the lease under which the gas is produced. (Pet., pp. 43-45, 21)

At page 3 of its Brief, Respondent states:

> "Neither the contract nor any lease or assignment thereunder labels this interest [Cabots' interest reserved under paragraph 4 of the contract] 'overriding royalty'."

If this were true is would be of no consequence (Respondent concedes at a later point that labels are unimportant (Resp. Br., p. 19)), because it cannot be denied, and we do not understand is denied by Respondent, that it is in fact an overriding royalty under Oklahoma decisions. But Respondent's statement quoted above is only literally and *technically* true. At page 34 of the Record there appears a provision in the contract between Petitioner and Respondent for reassignment of leases by Petitioner to Respondent under certain circumstances, and it is provided that in case of such reassignment Respondent shall drill on such tract and

> "If such drilling results in a commercially productive well, Cabot shall pay to Phillips as the gas is sold *the same amount of royalties to which Cabot would have been entitled under paragraph 4 above had Phillips drilled the well.*" (Emphasis supplied.)

Thus the contract *does* "label" Cabot's reserved interest as a "royalty" and no one contends that it makes any difference whether it is an "overriding" royalty or a landowner's royalty.

Moreover, Respondent has in other documents (R. 45, 51, 55) including the letter asserting its claim upon which this suit was brought (R. 119) "labeled" its interest as "overriding royalty."

In addition both courts below expressly "labeled" Cabot's interest as an "overriding royalty." (R. 16, 124)

protection of correlative rights. (Appendix A to Petition, paragraph 5.)

Respondent seeks to avoid the controlling effect which this and other courts uniformly give to the interpretation of administrative orders by the body which made them (Pet., pp. 16-19) by the following contentions:

(*1*) Order No. 28884 of the Corporation Commission is not in the record but appears only in the appendix to the petition and should not therefore be considered (Resp. Br., p. 8).

(*2*) The rule of the decisions cited is inapposite because the meaning of these minimum price orders had previously been established by the Supreme Court of Oklahoma and by this Court (Resp. Br., pp. 9, 18).

(*3*) The minimum price orders are not ambiguous and are therefore not susceptible to the interpretation placed upon them by the Commission which made them (Resp. Br., p. 18) and that order No. 28884 amounts to a new order, retroactive in effect, and beyond the power of the Commission to make (Resp. Br., p. 9).

(*4*) Order No. 28884 of the Commission is an attempt to adjudicate contract rights between private parties and is beyond the power of the Commission (Resp. Br., p. 10).

(*5*) Order No. 28884 amounts to an attempt by the Commission to overrule the decisions of the District Court and the Court of Appeals that under the contracts Respondent owned 1/4 of 7/8 of the gas in the reservoir and as produced, which the Commission is without power to do (Resp. Br., pp. 10, 11).

(*6*) The Commission was without power to "repeal, amend, modify or supplement a previous order issued by it"

in the absence of a change of conditions, and that no change in conditions appears (Resp. Br., p. 11).

(7) Order No. 28884 is in conflict with the decisions of the Supreme Court of Oklahoma in the *Cities Service* case, 203 Okl. 35, 220 P. (2d) 279, and the *Natural Gas Pipe Line* case, 272 P. (2d) 425,[2] and with its previous orders (Resp. Br., p. 11).

A number of these contentions will be answered as a group. The contentions being answered will be indicated by numbers at the commencement of the discussion corresponding with the number of its contention as stated above.

(1) With respect to the order of the Corporation Commission of July 16, 1954, interpreting and applying its minimum price order to the factual situation here involved, Respondent says that the order (Appendix A to the Petition) and the application therefor are no part of the record and "We are aware of no decision which justifies their consideration" (Resp. Br., p. 8).

This Court takes judicial notice of the law of the states. This includes the Commission's order, just as it does the statutes of the state and decisions by the State Supreme Court.[3]

(2) (3) (7) The principal basis for these contentions is that under Oklahoma law Respondent was the owner of

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2. Now pending on appeal to this Court, Nos. 320, 321 and 322, October Term 1954.

3. Courts of the United States administering the laws of a state will take judicial notice of all statutes, laws and decisions which a court of such state would take judicial notice of. *Covington Drawbridge Co.* v. *Shepherd*, 20 How. 227; *Gerling* v. *B. & O. R. Co.*, 156 U. S. 173; *Hanley* v. *Donoghue*, 116 U. S. 1.

The order here involved is one of which the Oklahoma Supreme Court will take judicial notice. *Oils, Inc.*, v. *Corporation Commission* 165 Okl. 202, 25 P. (2d) 703; *Groendylse Transport, Inc.*, v. *State*, 208 Okl. 602, 258 P. (2d) 670.

See also *Owings* v. *Hull*, 9 Peters 607, 625.

1/4 of 7/8 of the gas in the reservoir, as the courts below held, and that Respondent sold and Petitioner purchased this gas as it was produced; that the Supreme Court of Oklahoma held in the *Cities Service* and in the *Natural Gas Pipe Line* cases that the minimum price order applied to all sales of gas in the field and that as so construed the order served the purpose of conservation of gas and was constitutionally valid.

The basic contention of Respondent with respect to its ownership of the gas in the reservoir is not well taken under the Oklahoma decisions (Pet., pp. 42-45). The Oklahoma rule is that landowners and oil and gas lessees own only the right to search for and reduce to possession the oil and gas underlying the land and that no one owns these minerals until they are reduced to possession. Upon conveying to Petitioner the oil and gas leases, Respondent parted with all rights to search for and reduce the gas to possession. Not only so, but the contract provided that Petitioner should "become the owner of the gas *when* produced" which was the earliest time that anyone could own the gas under Oklahoma law. Respondent's only right under the contracts was to be paid a sum of money calculated by applying 4c per Mcf to 1/4 of 7/8 of the gas produced by Petitioner. Although Respondent now implies (but does not say) that its interest was not an overriding royalty (Resp. Br., p. 3) the fact is that the contract between the parties called it a royalty (R. 34) and that Respondent called it an overriding royalty in division orders which it signed (R. 45, 51, 55) and in asserting the claim upon which this suit was brought (R. 119), and both the District Court and the Court of Appeals so labeled it in their decisions in this case (R. 16, 124). There can be no doubt that under Oklahoma law Respondent's interest is properly labeled "over-

riding royalty" and that the payments to be made by Petitioner are not payment for gas but are part of the consideration for the leases which it bought from Respondent (Pet., p. 21).

Aside from this, whether Respondent was the technical owner of 1/4 of 7/8 of the gas in the ground or whether technically a sale of gas from Respondent to Petitioner took place upon production of the gas by Phillips, it is undeniable that the factual situations before the Supreme Court of Oklahoma in the *Cities Service* and the *Natural Gas Pipe Line Company* cases were entirely different from the one here presented in that the Oklahoma court was dealing with sales of gas by the lessees, who were also the producers, to pipe line companies. The sellers of gas there were the ones who bore the expense of drilling for and producing the gas. The Oklahoma court did not have before it and did not consider a "sale" of gas (if it may be called a sale) by one who owned no part of the lease, had no control of the drilling or production, or the disposition to be made of the gas, and who bore no part of the expense of those operations. To say, therefore, that the minimum price orders were construed by the Oklahoma Supreme Court so as to apply to this factual situation, is to give to those decisions a scope far beyond any factual justification and far beyond any intent that can be derived from the language used. Court opinions are to be construed and applied in the light of the facts before the court (Pet., p. 26; *Armour & Co.* v. *Wantock,* 323 U. S. 126, 132-133). It would be particularly obnoxious to apply that decision to a factual situation so different from the facts before the court that the effect upon conservation would be the opposite to the effect of those decisions (Pet., pp. 27-29).

It follows that the contention that the Oklahoma Supreme Court has settled the meaning of the price orders so as to preclude the Commission from placing its own interpretation upon them as applied to the facts of this case is wholly untenable.

It is equally clear that the Commission was empowered to interpret and apply the price orders to a factual situation such as here presented and to declare that it was not its intent to require producers to pay to persons in the position of Respondent any sum in addition to what the contract required. This is true regardless of whether Respondent be deemed technically the owner of gas in the reservoir, as Respondent contends, or that it be deemed not the owner of gas in the reservoir, as Petitioner contends. In either event the purposes of conservation are served by requiring the producer who bears the expense of production to obtain a minimum price for gas and are not served, but conservation is impeded and correlative rights are not protected by requiring such producer to pay additional sums as royalty or otherwise (Pet., pp. 27-31).

That the orders are not only susceptible to the interpretation placed upon them by Order No. 28884, but cannot reasonably be construed any other way, is sufficiently shown in the petition for the writ, pp. 35-45.

(4) (6) The contention that the Commission was without power to enter the order No. 28884 because it was an attempt to adjudicate contract rights between private parties and because there was no change in conditions shown is entirely frivolous in view of the Oklahoma Supreme Court's decision in the *Natural Gas Pipe Line Company* case construing and applying the minimum price order (Pet., p. 14).

(5) Order No. 28884 is no more an attempt to overrule the federal court's decision than is the decision of a state Supreme Court construing a state statute differently from the interpretation of the statute by a federal court. In each instance the decision has no direct impact upon the decision reached by the federal court. Only that court or an appellate court can change that decision. But since the federal courts are bound to apply state law as interpreted by the state tribunals, it is the duty of the federal court that rendered the decision, or the appellate court upon review of that decision, to adjust the decision to conform to the state tribunal's interpretation whenever such decision is called to its attention before its jurisdiction is exhausted (Pet., p. 20).

So it is clear that no tenable reasons have been advanced by Respondent against the recognition and application of the interpretation by the Corporation Commission of its own orders. Failure to apply the Commission's interpretation of its own orders necessarily means that the federal courts have usurped the powers of the state commission to administer the conservation laws of the state.

Respondent's defense to the asserted unconstitutionality of the minimum price orders as construed and applied in this case is predicated upon the assumption, and upon the holding of the Court of Appeals, that Respondent was the owner of 1/4 of 7/8 of the gas in the reservoir and sold this gas to Phillips at the time of production for 4c per MCF. Other miscellaneous statements are made in the course of Respondent's argument based upon statements of facts unsupported by the record and which are wholly irrelevant to the issues.

We have pointed out in the Petition for Certiorari (pp. 42-45, 21) and in the discussion above that the Court of Appeals failed to follow the decisions of the Supreme Court of Oklahoma relating to the ownership of oil and gas in place and the nature and character of overriding royalty, such as Cabot's. We have further shown above that even though it be concluded that the Court of Appeals was right in holding that Cabot reserved an undivided interest in the gas in place and sold that gas to Phillips upon production, that was not the kind of sale and purchase which the Supreme Court of Oklahoma and this Court had for consideration in the *Cities Service* case, and which the Oklahoma court had for consideration in the *Natural Gas Pipe Line* case, and therefore that the decisions in those cases cannot properly be regarded as having held that the minimum price orders require a producer, such as Petitioner, to pay one in the position of Respondent (whatever label may be placed upon its interest) for the gas (*supra*, p. 6). It is even more certain that those decisions cannot be regarded as having established the constitutional validity of these orders as applied to this factual situation (Pet., pp. 24-27).

Aside from its contention that the decision of the Supreme Court of Oklahoma and the decision by this Court in the *Cities Service* case settled the constitutionality of these orders, Respondent rests its defense of constitutionality upon the bare assertion that Petitioner unsuccessfully contended in the *Cities Service* case that the orders did not prevent waste or protect correlative rights (Resp. Br., p. 25). An examination of the briefs filed in that case will disclose that Petitioner's contention there was that as applied to sales by a producer, such as Phillips, to a pipe line company, the evidence failed to show that there had been any waste in the Guymon-Hugoton Field or that the minimum

prices would prevent waste in the future. The Courts were not there considering, and Petitioner's argument was not addressed, and could not have been addressed under the record in that case, to a factual situation, such as the one here presented. Therefore, the failure of the Courts to hold under the record in that case that the minimum price orders had no relation to the prevention of waste or the protection of correlative rights is without significance in determining the constitutional validity of the orders as applied to the factual situation here presented.

Respondent does not respond to the merits of the argument made by Petitioner (Pet., pp. 27 to 31) that the orders as applied to the facts of this case do not prevent but rather accentuate waste and in no way protect correlative rights.

We shall not undertake to answer all of the miscellaneous irrelevant statements by Respondent, unsupported by record references. We do desire, however, to mention two assertions made by Respondent on page 23 of its brief, *i. e.*, "Petitioner also ignores the fact that its own enrichment under the Commission's orders far exceeds Cabot's. • • • On the sale by Phillips of its share of the gas produced from the leaseholds involved here alone, Phillips will receive $3.00 for every additional dollar it pays Cabot."

Petitioner in fact received nothing whatever by reason of the original 7c order under which Respondent has been adjudged by the Court beolw to be entitled to 3c per MCF in addition to the 4c provided by the contract. Petitioner was already receiving, or at least the Corporation Commission and the Courts so held, 7c for the gas which it produced.

The amount that Petitioner will receive by virtue of the 9.8262c order depends upon the price which it was receiving at the time the order was made and would have received in the future, which facts are not shown by the record. Respondent erroneously assumes that Petitioner will receive increases under these orders in direct propor-

tion to the increases received by Cabot, which definitely is not the fact. That would only be true if Petitioner had been receiving only 4c for its gas, and as has already been pointed out, the Commission and the Courts decided that Phillips was receiving at least 7c per MCF at the time the original order was made.

All of this, of course, is entirely irrelevant to the issues in this case. The point is that the Commission and the Courts have held that the public interest is served by requiring a producer of gas to receive a minimum price for that gas, whereas the Commission has held that conservation is not promoted and correlative rights are not protected, from which it follows that no public interest is served, by requiring a producer, such as Phillips, to pay additional sums to one, such as Cabot, who has no voice in the production and bears no part of the cost. It matters not therefore that the producer may profit, whereas the fixed price overriding royalty owner may not profit, by virtue of minimum price orders having judicial sanction as being in the public interest. *Cities Service Gas Co.* v. *Peerless Oil & Gas Co.*, 340 U. S. 179, 187.

Respectfully submitted,

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